that market.[22] This phenomenon will increase after the merger. As a result, enforcing rules requiring Qwest and other LECs to convert the newly merged entities' circuits will not result in lower prices for customers – prices are determined by the marginal costs of the *highest-cost* firms. LECs' circuit-flipping duty under the rules will thus merely increase the profits of the new merged entities, while simultaneously eviscerating their incentives to make facilities-based investments, without benefiting customers.[23]

In addition, as noted above, requiring Qwest and other LECs to convert the post-merger companies' special access circuits to UNEs would stifle competition in the MegaBOCs' home regions by enabling them to discourage other ILECs – including Qwest – from providing service there.[24] Similarly, Qwest's (and other LECs') circuit-flipping obligations in this context would stifle enterprise market competition outside of the MegaBOCs' regions by facilitating tacit collusion between the companies out-of region.[25] Ultimately, telecommunications consumers would suffer from higher rates, reduced choice, and less innovation as the MegaBOCs effectively create in-region monopolies and out-of-region duopolies for bundled telecommunications services.

The Requirements of Section 251(c) Have Been Fully Implemented: The Commission should forbear from applying its circuit flipping rules because the "fully implemented" requirement of section 10(d) has been satisfied. More specifically, the requirements of Section 251(c) have been incorporated into the competitive checklist in Section 271(c), so the Commission's approval of Qwest's Section 271 applications in all

[22] Wilkie Declaration ¶ 25.

[23] *See id.* ¶¶ 25-28.

[24] *See id.* ¶¶ 47-49.

[25] *See id.* ¶¶ 35-43.

of its states necessarily includes a finding that Section 251(c) has been "fully implemented."

II. SPECIFIC FORBEARANCE REQUESTED

Pursuant to Section 10(c) of the Communications Act, 47 U.S.C. § 160(c), Qwest petitions the Commission to forbear from enforcement of Commission Rules 51.309, 51.315, 51.316 and 51.318 to the extent those provisions would require Qwest and other LECs to convert the MegaBOCs' existing special access circuits to UNEs.[26] Qwest seeks this forbearance only with respect to its duty (and other LECs' duty) as it applies to the post-merger entities' circuits. If one or both of the mergers fails to occur, Qwest will withdraw this Petition as to the non-merging parties. To ensure conformity with the goals underlying the Communications Act, Qwest requests that the Commission begin forbearing upon consummation of either or both of the proposed mergers, and that it "re-convert" to tariffed rates all of the MegaBOCs' circuits that were converted between the date of this filing and the effective date of its grant, retroactive to the date on which this Petition was filed.

This Petition is not intended to affect the ongoing assessment of "circuit flipping" and the availability of special access UNEs as part of the Commission's special access proceeding[27] and the *TRRO*, nor is it intended to prejudice Qwest's position in those proceedings.[28] The pending mergers, however, require the Commission to take

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[26] *See* 47 U.S.C. § 251(c)(3); 47 C.F.R. §§ 51.309, 51.315, 51.316, 51.318.

[27] *See Special Access Rates for Price Cap Local Exchange Carriers; AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, Order, 20 FCC Rcd. 11701 (2005).

[28] In those proceedings, Qwest, like SBC and Verizon, has unequivocally opposed "circuit flipping" on the grounds that the practice undermines facilities-based competition and is not necessary to ensure competitive options for consumers. *See, e.g., Unbundled Access to Network Elements, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers,* WC Docket Nos. 04-313, 01-

immediate action with respect to the new entities that threaten the enterprise market. For now, the Commission should tailor its forbearance only to Qwest's (and other LECs') duties as they apply to the post-merger MegaBOCs, allowing other carriers to continue converting circuits to the extent the current rules and the carriers' interconnection agreements allow, pending the completion of the special access proceeding and *TRRO* appeal, and thereafter if necessary.

III. BACKGROUND

A. The Evolution of the Circuit-Flipping Rules.

The Commission's *Local Competition Order*, which initially implemented the 1996 Act, did not address the question of circuit flipping.[29] The subsequent *UNE Remand Order*, however, indicated that "substitution of unbundled network elements for special access" was permissible but declined to impose eligibility thresholds for UNE access.[30] The ILECs objected that this permissive approach would "have significant effects in the competitive local exchange market," and the Commission agreed, restricting the ability of a competitive carrier to convert special access arrangements to UNEs except where the carrier provided a "significant amount of local exchange services."[31] In its *Supplemental Order Clarification*, the Commission clarified this use

338, Comments of Qwest Communications International Inc. at 30, 70, 75 (filed Oct. 4, 2004); Reply Comments of Qwest Communications International Inc. at 17-19, 64-68 (filed Oct. 19, 2004).

[29] *See Local Competition Order*, 11 FCC Rcd. 15499. The circuit-flipping controversy focused originally on "enhanced extended loops," or "EELs," which consisted of ILECs' offerings of a combination of a special access loop and transport. The circuit-flipping debate has evolved, and now covers all special access facilities that are subject to conversion to TELRIC prices.

[30] *See Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, Third Report and Order and Fourth Further Notice of Proposed Rulemaking, 15 FCC Rcd. 3696, 3911-12 (¶ 484) (1999) ("*UNE Remand Order*").

[31] *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, Supplemental Order, 15 FCC Rcd. 1760, 1761 (¶¶ 2, 4) (1999) ("*Supplemental Order*").

restriction by defining three safe harbors that met the requirement of a "significant amount of local exchange service."[32]

The Commission's more recent *Triennial Review Order* clarified the circumstances under which a carrier can convert its leased special access circuits to TELRIC-priced UNEs. A LEC is now eligible to flip its special access circuits purchased under tariff so long as that circuit (1) is not used "exclusively" for interexchange or CMRS service and (2) meets several "local" criteria established in the FCC's rules.[33] The FCC ruled that impairment was not contradicted by the fact that the circuit had been purchased at the tariffed rate, and that any carrier would be "impaired" without access to the same circuit at UNE rates if it provides local voice service over the circuits in question.[34] Subsequently, in the February 2005 *TRRO*, the Commission further clarified the application of the rules, concluding that mobile wireless services and long distance services are sufficiently competitive that carriers seeking to provide them cannot be considered impaired without access to facilities leased as UNEs.[35]

In the case of high-capacity loops, the rules provide that a LEC is "impaired" with respect to a particular wire center if that wire center is home to fewer than four "fiber-based collocators," does not serve more than a predetermined number of business lines

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[32] *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, Supplemental Order Clarification, 15 FCC Rcd. 9587, 9598-600 (¶ 22) (2000) ("*Supplemental Order Clarification*"). That clarification was upheld in *CompTel v. FCC*, 309 F.3d 8 (D.C. Cir. 2002).

[33] *See* 47 C.F.R. § 51.318.

[34] *See* 47 C.F.R. §§ 51.316, 51.318, 51.319.

[35] *See TRRO*, 20 FCC Rcd. at 2551-55 (¶¶ 34-36). While Qwest believes the Commission's *TRRO* decision was legally erroneous, it does not challenge that decision in this Petition and instead proceeds with the understanding that the current circuit flipping rules remain in effect. Qwest notes, however, that it has filed a petition for judicial review of the *TRRO* decision, focusing in particular on the Commission's decision to expand carriers' right to convert special access circuits to UNE arrangements. *See* Qwest Corporation Petition for Forbearance Pursuant to 47 U.S.C. § 160(c), WC Docket No. 04-223 (filed June 21, 2004).

(38,000 for DS-3 capacity loops, and 60,000 for DS-1 capacity loops), and has no access to dark-fiber loops.[36] Within these parameters, a special access circuit can be flipped only if the LEC "actually provides a local voice service" over the circuit in question, including having "at least one local number assigned to each circuit and . . . provid[ing] 911 or E911 capability to each circuit."[37]

High-capacity special access circuits (*i.e.*, DS1 and DS3 loops) are among the network elements subject to the unbundling rules. When the applicable eligibility criteria have been satisfied, ILECs must unbundle these elements even if the ILEC offers a special access lease of the identical circuit under tariff. The unbundled elements are priced based on TELRIC, which enables eligible carriers to purchase the equivalent of special access circuits at approximately half the tariffed price.

Throughout the evolution of the Commission's circuit-flipping rules, Qwest, SBC, and Verizon have all consistently maintained that permitting access to facilities at TELRIC rates absent genuine impairment retards the 1996 Act's goal of facilities-based competition.[38] The Commission itself has emphasized that its unbundling obligations apply only when "carriers genuinely are impaired without access to particular network elements *and where unbundling does not frustrate sustainable, facilities-based*

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[36] *See* 47 C.F.R. § 51.319(a)(4)(i), (5)(i); *see also TRRO*, 20 FCC Rcd. at 2536, 2558-59, 2563-64, 2629-33 (¶¶ 5, 43, 53, 174-181).

[37] *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers; Implementation of the Local Competition Provisions of the Telecommunications Act of 1996; Deployment of Wireline Services Offering Advanced Telecommunications Capability*, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd. 16978, 17354 (¶ 597) (2003) ("*TRO*"); *see also* 47 C.F.R. § 51.318(b)(2).

[38] *See USTA II*, 359.3d at 576 ("[T]he purpose of the Act is not to provide the widest possible unbundling, or to guarantee competitors access to ILEC network elements at the lowest price that government may lawfully mandate. Rather, its purpose is to stimulate competition--preferably genuine, facilities-based competition. Where competitors have access to necessary inputs at rates that allow competition not only to survive but to flourish, it is hard to see any need for the Commission to impose the costs of mandatory unbundling.").

competition."[39] This pronouncement reflects the Commission's well-founded concern that unchecked circuit flipping "could undercut the market position of many facilities-based competitive access providers."[40]

Like the Commission, the D.C. Circuit has recognized that "[t]he purpose of the [1996] Act is not to provide the widest possible unbundling, or to guarantee competitors access to ILEC network elements at the lowest price that government may lawfully mandate."[41] Thus, the court explained, "[w]here competitors have access to necessary inputs at rates that allow competition not only to survive but to flourish, it is hard to see any need for the Commission to impose the costs of mandatory unbundling."[42]

Neither Congress nor the Commission developed the current unbundling regime with two dominant MegaBOCs in mind. Indeed, at the time Congress debated and passed the 1996 Act, eight large ILECs (seven independent RBOCs plus GTE) provided regional service to the consumer and enterprise markets, and three independent interexchange carriers (AT&T, MCI and Sprint) provided long-distance service. Likewise, the Commission did not issue the *Local Competition Order,* the *TRO,* or the *TRRO* to address a market dominated by two heavyweights – indeed, at the time the *Local Competition Order* was issued in 1996, the MegaBOCs were split into at least fourteen separate and independent ILEC, IXC and CLEC companies.[43]

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[39] *TRRO*, 20 FCC Rcd. at 2535 (¶ 2) (emphasis added).

[40] *Supplemental Order Clarification*, 15 FCC Rcd. at 9597 (¶ 18).

[41] *USTA II*, 359 F.3d at 576.

[42] *Id.*

[43] SBC merged with or acquired Pacific Telesis, Ameritech, Southern New England Telephone, and Woodbury Telephone. AT&T acquired Teleport. Verizon was formed from the merger of GTE with the former Bell Atlantic and NYNEX. MCI acquired MFS and Brooks Fiber, along with the long distance business of Worldcom, all of which were formed from other roll-ups. This list of consolidations does not include the transactions that created Cingular and Verizon Wireless.

It is highly unlikely, therefore, that the Commission adopted its circuit-flipping rules to provide the new industry giants with economic incentives *not* to construct competitive telecommunications facilities, especially since such construction is very much within their means. But that is precisely what will happen absent forbearance. As further set forth below, this Petition urges the Commission to use forbearance to adjust its unbundling regime – and, specifically, its circuit-flipping rules – with respect to these two MegaBOCs to take these changed circumstances into account.

B. SBC and Verizon Have Consistently Recognized that Circuit Flipping Diminishes Economic Incentives to Construct Competitive Telecommunications Facilities.

The merging parties themselves have long recognized the harmful impact circuit flipping has on facilities-based competition and have consistently argued that the 1996 Act forbids special access conversions in all contexts. Since "CLECs using existing special access services are already successfully serving customers," Verizon has argued, "those competitors don't need to convert their special access circuits to UNEs."[44] To the contrary, Verizon has maintained that "it is not only unnecessary, but counterproductive – and unlawful – for the Commission to permit competing carriers of any size to use (or convert to) UNE-based alternatives."[45] Indeed, Verizon has told the Commission that the "sole effect" of requiring LECs to convert carriers' existing special access circuits to UNE pricing "is a price break that increases the competing carrier's profits."[46]

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[44] *Unbundled Access to Network Elements; Review of Section 251 Unbundling Obligations for Incumbent Local Exchange Carriers*, WC Docket No. 04-313, CC Docket No. 01-338, Verizon ex parte, attachment at 9 (filed Dec. 7, 2004) ("Verizon Dec. 7, 2004 ex parte").

[45] *Id.* at 1.

[46] *Id.* at 1-2. *See also U.S. Telecom Ass'n v. FCC*, Joint Motion for Stay and Expedition, No. 03-1263, at 17-18 (D.C. Cir. Sept. 12, 2003); *Unbundled Access to Network Elements; Review of Section 251 Unbundling Obligations for Incumbent Local Exchange Carriers*, WC Docket No. 04-313, CC Docket No. 01-338, Comments of Verizon at 2-3 (filed Oct. 4, 2004) ("Wherever demand for high-capacity services

SBC's opposition to circuit flipping (and substituting UNEs for special access circuits in general) also has been particularly vehement. Indeed, in "renegotiating" its special access rates with Qwest's long-distance affiliate for access service within the SBC region, SBC has unilaterally imposed a requirement that virtually all of Qwest's purchases from SBC be tariffed services, not UNEs or resale services. Specifically, SBC has insisted that, in order to obtain a discount for volume and term commitments, Qwest must also agree that 95 percent of what it spends on DS1 and DS3 facilities and services be spent on tariffed services – and that no more than 5 percent of these expenditures can be used for the purchase of UNEs or resold retail local services.[47] This requirement is independent of Qwest's required adherence to term and volume commitments (which are the normal hallmark of volume discount plans). SBC can hold Qwest in default under the tariff (subject to massive termination liability) if Qwest simply purchases new UNEs for

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and facilities exists, carriers are competing successfully using a combination of their own or alternative facilities and special access service to serve end-user business customers, and are doing so in many instances more successfully than Verizon itself. Under these facts and the case law that has been developed in five different decisions of the Supreme Court and the D.C. Circuit, the Commission may not require unbundling of high-capacity facilities."); *id.* at 31 ("[T]he Commission may not require unbundling of high-capacity loops or dedicated transport, including dark fiber loops."); *id.* at 65 ("[T]he Commission should eliminate unbundling of all high-capacity facilities in all markets. This is the approach that best squares with *USTA II* and the market facts, and that is most likely to further the Act's goals of promoting facilities-based competition."); Reply Comments of Verizon at 3-4 (filed Oct. 19, 2004) ("[T]he market for high-capacity facilities and services remains a mature, competitive market. Wherever demand for such facilities and services exists, carriers are successfully competing to serve that demand using a combination of their own or alternative facilities and special access. . . . Verizon's own experience competing out-of-region confirms the availability of such competitive wholesale facilities."); *id.* at 5 ("Despite CLECs' assertions that they cannot compete successfully or profitably using special access, the facts show . . . that CLECs relying primarily or exclusively on special access . . . have reported positive EBITDA."); Verizon Dec. 7, 2004, ex parte at 2 ("[T]he fact that some carriers are competing successfully with special access suggests that other carriers can compete in the same manner and do not need access to individual high-capacity UNEs or EELs."); *Unbundled Access to Network Elements; Review of Section 251 Unbundling Obligations for Incumbent Local Exchange Carriers*, WC Docket No. 04-313, CC Docket No. 01-338, Verizon ex parte at 1 (filed Dec. 8, 2004) ("Imposing broad unbundling requirements will undermine the continued development of facilities-based competition for high-capacity services and the viability of the wholesale market.") ("Verizon Dec. 8, 2004 ex parte").

[47] A copy of the tariff proposal is attached as Exhibit C.

the sole purpose of competing against SBC locally, even if Qwest continues to comply with the volume commitments on which the tariff is predicated.

This proposal includes a provision that, if Qwest merges with a company that provides competitive services within SBC's region using high capacity UNE loops or transport, any such UNEs will count immediately against the 5 percent limitation on UNEs. Failure to eliminate sufficient UNEs to bring the total back to the 95 percent floor is considered to be a "breach" of contract punishable by enormous termination penalties (not simply loss of the discounts). SBC thus not only takes the view that circuit flipping is inappropriate, it has also taken steps to ensure that Qwest (or any other party that must purchase special access from SBC through volume and term commitments) cannot purchase any significant number of UNEs in SBC's home region.

SBC accordingly could not object to the Commission forbearing from the circuit-conversion rules as requested in this Petition. Indeed, the statements of SBC and Verizon have particular resonance considering the size of the merged companies and the number of existing tariffed special access circuits they will control. Now that they are on the cusp of merging with IXCs, SBC and Verizon stand to reap the unjustified profits via circuit conversions that they have previously decried. Thus, the Commission should take stock of the positions that SBC and Verizon have taken on this issue in the past, and it should scrutinize carefully any attempt to adopt a new position here.

C. The MegaBOCs' Dominance of the Enterprise Market

As applied to the post-merger MegaBOCs, Qwest's and other LECs' circuit-flipping obligations would have unique and pernicious anticompetitive effects on a particularly important telecommunications market – the "enterprise" market. While

characterizations vary, the enterprise market is generally understood to include Fortune 1000 companies, federal government agencies, major state government entities, and large public institutions.[48] Such entities are, of course, primarily interested in obtaining "bundled" services from a single provider, as opposed to purchasing specific services – such as "local" or "long distance" services – from multiple providers.

Requiring Qwest and other LECs to convert the MegaBOCs' special access circuits would have a significant impact in the enterprise space because it would allow the industry heavyweights to consolidate their already dominant positions in that market. Notwithstanding the MegaBOCs' frequent protestations in the merger dockets,[49] analysts recognize that "AT&T and MCI . . . retain the bulk of enterprise market share" and that their merger partners, SBC and Verizon, have emerged as the most prominent challengers to the IXCs' dominance.[50] Indeed, analyst Sanford Bernstein reports that AT&T and MCI together control 58 percent of the enterprise voice market and 63 percent of the enterprise data market,[51] and it also reports that enterprise customers are often hesitant to break ties with their existing providers.[52] Bear Stearns has reported even greater market

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[48] *See, e.g., Verizon Communications Inc. and MCI, Inc., Applications for Approval of Transfer of Control*, WC Docket No. 05-75, Public Interest Statement at 9 n.3 (filed March 11, 2005) ("Verizon/MCI Public Interest Statement"); Mike McCormack (Bear Stearns), Highlights from Meetings with Enterprise Telecom Consultants at 1 (June 17, 2005) ("Bear Stearns Report") (attached as Exhibit D).

[49] *See, e.g., Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorization from AT&T Corp. to SBC Communications Inc.*, WC Docket No. 05-65, Description of Transaction, Public Interest Showing, and Related Demonstrations at 7 (filed Feb. 21, 2005) ("SBC/AT&T Description of Transaction") ("Nor will the proposed transaction adversely affect competition in the provision of services to large and medium-sized businesses [because] many competitors with different strategies and competitive strengths are competing, making coordination virtually impossible."); Verizon/MCI Public Interest Statement at 9 ("[T]he transaction does not harm competition in any traditional market segment, and the combining companies are not 'among a small number of . . . most significant market participants' for any relevant service or for any relevant customer group.").

[50] Sanford Bernstein Enterprise Report at 12-13; *see also* Wilkie Declaration ¶ 11.

[51] *See* Sanford Bernstein Enterprise Report at 12.

[52] *See id.* at 41.

concentration, finding that "AT&T and MCI combined have roughly 80 percent market share of enterprise telecom" and observing that the "incumbent telecom provider for large enterprise has a significant advantage in negotiations."[53] Thus, without even considering the impact of the circuit-flipping rules, the mergers "will leapfrog the organic entry of at least the two largest Bells into the enterprise space,"[54] thereby cementing the MegaBOCs' dominant positions in the market, far ahead of Sprint, BellSouth and Qwest. This Commission should take steps now to ensure that the merging entities do not turn the enterprise market into a duopoly and thereby increase their dominance of other telecommunications markets as well.

IV. SECTION 10 REQUIRES THE COMMISSION TO FORBEAR FROM ENFORCING RULES THAT REQUIRE QWEST AND OTHER LECS TO CONVERT THE MEGABOCS' SPECIAL ACCESS CIRCUITS TO TELRIC PRICING

In adopting the Telecommunications Act of 1996, Congress recognized that outdated or unintended applications of the Act's provisions or implementing regulations could impede the core goals of competition, innovation, and improved prices and services for consumers. Congress therefore empowered – and, indeed, required – the Commission to "forbear" from enforcing any statutory provision or regulation that would hamper the achievement of those goals. The Commission has recognized that its forbearance obligation is an "integral part" of the Act's "'pro-competitive, deregulatory national policy framework' to make available to all Americans advanced telecommunications and information technologies and services 'by opening all telecommunications markets to

[53] Bear Stearns Report at 1.

[54] Sanford Bernstein Enterprise Report at 12-13.

competition.'"[55] Of particular relevance to this Petition, the Commission has recognized that its forbearance authority provides a valuable tool for removing statutory and regulatory provisions that may impede the emergence of facilities-based competition.[56]

Section 10 of the Act sets forth a three-pronged test for forbearance.[57] Specifically, Section 10(a) imposes the obligation to forbear when: (1) forbearance from enforcing the regulation or provision is "consistent with the public interest;" (2) enforcing the regulation or provision in question is not necessary to ensure that the charges and practices of carriers "are just and reasonable and not unjustly or unreasonably discriminatory;" and (3) enforcing the regulation or provision "is not necessary for the protection of consumers."[58] With respect to the first factor – whether forbearance is consistent with the public interest – Section 10(b) requires the Commission to consider the impact of forbearance on competitive market conditions, including the extent to which forbearance "will enhance competition among providers of telecommunications services."[59] Section 10(d), specifies, however, that "the Commission may not forbear from applying the requirements of section 251(c) . . . until it determines that those requirements have been fully implemented."[60]

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[55] *Petition for Forbearance of Iowa Telecommunications, Inc. d/b/a Iowa Telecom Pursuant to 47 U.S.C. § 160(c) from the Deadline for Price Cap Carriers to Elect Interstate Access Rates Based on the CALLS Order or a Forward Looking Cost Study,* 17 FCC Rcd. 24319, 24321 (¶ 6) (2002), *quoting* Joint Explanatory Statement of the Committee of Conference, S. Conf. Rep. No. 104-230, at 1 (1996).

[56] *See Petition for Forbearance of the Verizon Telephone Companies Pursuant to § 160(c)*, Memorandum Opinion and Order, 19 FCC Rcd. 21496, 21508, 21511 (¶¶ 25, 31-32) (2004) ("*Section 271 Forbearance Order*").

[57] 47 U.S.C. § 160. Section 10(c) authorizes any telecommunications carrier to submit a petition to the Commission requesting that it exercise its forbearance authority. *See* 47 U.S.C. § 160(c).

[58] 47 U.S.C. § 160(a)(1)-(3).

[59] 47 U.S.C. § 160(b).

[60] 47 U.S.C. § 160(d).

As explained below, each of these criteria has been satisfied in this instance, and the Commission must therefore forbear from enforcing its circuit-flipping rules to the extent they would require Qwest and other LECs to convert the post-merger MegaBOCs' special access circuits to UNE pricing.

A. Forbearance is in the Public Interest

Consistent with Section 10(a)(3) and Section 10(b), forbearance from applying the circuit-flipping rules would serve the public interest in at least four ways. Specifically, forbearance would (1) encourage facilities-based competition; (2) remove the MegaBOCs' ability to use circuit-flipping threats to stave off competitive advances from other ILECs seeking to provide service out-of-region; (3) prevent the MegaBOCs from stifling competition in the enterprise sector; and (4) reduce the MegaBOCs' incentive to engage in tacitly collusive behavior. In addition, forbearance is appropriate because requiring Qwest and other LECs to convert the MegaBOCs' circuits would not lead to any consumer or economic benefits that might otherwise counterbalance the resulting harms.

1. Forbearance Will Encourage Facilities-Based Competition

Requiring Qwest and other LECs to convert the MegaBOCs' circuits notwithstanding their unrivaled resources and dominant market positions would subvert Congress' goal of encouraging facilities-based competition. The post-merger MegaBOCs will clearly have the financial wherewithal to construct competitive facilities, and they would presumably do so absent regulatory disincentives. As SBC and Verizon have themselves emphasized, however, allowing circuit flipping represents just such a disincentive, because it allows carriers to substitute the cost of leasing UNEs at TELRIC

prices for the cost of building their own competing facilities as the 1996 Act had envisioned.[61] Whatever the appropriate policy balance is for smaller, less-endowed entities, the disincentive to facilities construction here is particularly troubling because the merging parties have touted new facilities construction as a key benefit of the mergers.[62]

Moreover, the problem of discouraging investment in competitive facilities would be compounded because forcing LECs to convert the MegaBOCs' existing circuit leases to UNEs (rather than encouraging the MegaBOCs to build new facilities) would deprive the LECs of critical special access revenue and thereby hamper *their* ability to undertake the expense of constructing new facilities as well, and also undercut their incentives to invest in new enhanced facilities. In addition, circuit flipping in this context would also signal other potential competitors that the competitive scales were tipped against them through regulation, further thwarting competitive entry.

Congress passed the 1996 Act with the core goal of *encouraging facilities-based competition.*[63] Permitting emerging competitors to obtain UNEs was intended as a *temporary* measure to take account of the practical realities that not all new carriers would possess sufficient customer bases to justify building out competing facilities immediately, and that such carriers might find entry unattractive if required to pay the ILEC's special access rate to gain access. The Commission's circuit conversion rules,

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[61] *See supra* Section III.B.; *see also* Wilkie Declaration ¶¶ 50-53.

[62] *See, e.g.,* SBC/AT&T Description of Transaction at 21 ("[T] he combined company will be a well-managed, well-financed, U.S.-owned company with the resources to make capital investments in facilities and networks . . . ."); Verizon/MCI Public Interest Statement at 15 ("The combination of Verizon and MCI also promises medium- and long-term benefits as the combined entity will bring increased investment to critical network infrastructure and accelerate the delivery of innovations to all consumers.").

[63] *See supra* Section III.A.

however, require LECs to convert even the largest carriers' circuits to UNE pricing. What's more, the Commission's circuit-flipping rules allow such companies the benefit of UNE rates even when they *already* provide service using special access facilities – and thus plainly demonstrate that they *can* provide service using leased special access circuits.

Of course, the Commission's recent decisions explain that a competitor may *not* take advantage of the circuit flipping rules unless it would be "impaired" without access to UNEs at TELRIC rates. Qwest, like SBC and Verizon, has consistently maintained that it *never* makes sense to find that a competitive carrier would be "impaired" in providing services it *already* provides without UNEs.[64] This concern is especially applicable with respect to the MegaBOCs. If, for some reason, the MegaBOCs were to desire to cease using the special access circuits that AT&T and MCI lease now (generally at rates reflecting their enormous bargaining power), they have the capital resources to do what the 1996 Act intended – provide service by *constructing their own facilities.* In short, irrespective of the merits of the circuit flipping debate with regard to *other* competitors, there is no pro-competitive reason to require Qwest and other LECs to convert the MegaBOCs' existing circuits to UNE prices.

It also bears emphasis that while the MegaBOCs claim that one of the benefits of the mergers will be to give them a greater ability to move to IP-based networks and offer innovative services, forcing Qwest and other LECs to flip the MegaBOCs' circuits would discourage IP investment in particular. Specifically, enforcing Qwest's (and other LECs') circuit-flipping duty would allow the MegaBOCs to cut their costs of providing

[64] *See, e.g., Unbundled Access to Network Elements; Review of Section 251 Unbundling Obligations for Incumbent Local Exchange Carriers*, WC Docket No. 04-313, CC Docket No. 01-338, Comments of Qwest Communications International Inc. at 24-30 (filed Oct. 4, 2004).

service by hundreds of millions of dollars per year simply by adding legacy voice products using ATT's and MCI's extensive inventories of legacy switches. This capability, of course, naturally *reduces* the merging parties' incentives to invest in new IP-based technology.

In sum, the forbearance that Qwest seeks serves the public interest by removing the regulatory disincentive to facilities deployment by the companies best situated to construct their own facilities. Indeed, the four providers with the greatest ability to build out new facilities are SBC, AT&T, Verizon, and MCI, the soon-to-be merged companies. Forcing Qwest and other LECs to grant the MegaBOCs access to high-capacity circuits out-of-region at TELRIC-based rates for these circuits that are already being purchased under special access tariffs would not help the public; it would instead only provide those companies an enormous windfall. Even if SBC and Verizon elected not to build out their own facilities, they could compete successfully out-of-region without relying on other LECs' circuit-flipping duties simply by continuing to lease facilities from other ILECs at just and reasonable tariffed rates. As the D.C. Circuit has observed, "competitors cannot generally be said to be impaired [in entering local markets] by having to purchase special access services from ILECs, rather than leasing the necessary facilities at UNE rates."[65] Similarly, as SBC has pointed out, "[t]he Commission's role … isn't to pad CLEC margins or to give them a risk-free method of serving enterprise customers. Indeed, the

[65] *USTA II,* 359 F.3d at 592. No matter how this language is read with respect to most CLECs, it stands in stark contrast to any effort to claim that competition would be promoted by the ability of the megaBOCs to flip existing circuits.

Commission already tried that gambit in the mass-market, and all it has to show for it is the suppression of the real, facilities-based competition the Act was designed to foster."[66]

2. *Forbearance Will Prevent the Post-Merger MegaBOCs from Threatening Retaliation to Thwart Other ILECs' Efforts to Compete in the MegaBOCs' Home Regions*

As further discussed below, the MegaBOCs have touted their merger plans as a means of increasing their ability to compete outside of their home markets. Absent forbearance, however, requiring Qwest and other LECs to convert the post-merger companies' circuits would actually *decrease* competition out-of-region by, in the words of Dr. Wilkie, giving the MegaBOCs "an effective tool to punish pro-competitive actions taken by Qwest or other carriers."[67] In light of the massive special access inventories that AT&T and MCI already possess, the merged companies will be able to wield a powerful economic hammer to stop Qwest and other ILECs from offering service in the MegaBOCs' home regions.[68]

If Qwest or another ILEC were to start offering such service, the MegaBOCs could rely on the circuit-flipping rules to oblige the competitor to flip the MegaBOCs' special access circuits to UNE pricing, thus instantly decimating the competing ILEC's special access revenues. This would make economic sense whenever the economic benefits of squelching in-region competition would offset the savings to be realized from flipping circuits out of region. Given the level of revenues at stake within the

[66] *Unbundled Access to Network Elements; Review of Section 251 Unbundling Obligations for Incumbent Local Exchange Carriers*, WC Docket No. 04-313, CC Docket No. 01-338, Reply Comments of SBC at 16 (filed Oct. 19, 2004); *see also* Verizon Dec. 7, 2004 ex parte, attachment at 11 ("[T]here is no need for – and substantial harm to the economy would result from – any FCC decision to require incumbents to provide high-capacity facilities at TELRIC rates.").

[67] *See* Wilkie Declaration ¶ 47.

[68] *See id.* ¶¶ 23, 47-49.

MegaBOCs' home regions, even a relatively small in-region threat could prompt the MegaBOCs' to take retaliatory action against other ILECs.

Allowing the MegaBOCs to use other LECs' circuit-flipping obligations to protect their home markets would be particularly ironic given that they have tried to generate support for the mergers by arguing that they will, post-merger, be able to increase their competitive efforts outside of their home markets. For instance, SBC and AT&T have asserted that "[t]he very purpose of this transaction . . . would be defeated, and much of the $16 billion investment squandered, if the combined company were not to compete everywhere, including outside of SBC's region."[69] Likewise, Verizon and MCI have explained that "the vertical aspects of this transaction are overwhelmingly pro-competitive – the combination of Verizon's and MCI's complementary operations will make the combined company a more vibrant competitor for enterprise customers both within and outside of Verizon's franchise territory."[70]

Unless the Commission forbears from applying the circuit-flipping rules in this context, the MegaBOCs will have the power to expand unchecked into other ILECs' home territories while unleashing economic devastation on any ILEC that dares to enter their regions. **[**BEGIN CONFIDENTIAL**]**

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[69] *Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from AT&T Corp., Transferor to SBC Communications Inc., Transferee,* WC Docket No. 05-65, Joint Opposition of SBC Communications Inc. and AT&T Corp. to Petitions to Deny and Reply to Comments at 134-135 (filed May 10, 2005).

[70] *Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control,* WC Docket No. 05-75, Joint Opposition of Verizon Communications Inc. and MCI, Inc. to Petitions to Deny and Reply to Comments at 15-16 (filed May 24, 2005).

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[72] **[**END CONFIDENTIAL**]** Absent forbearance, the post-merger MegaBOCs would have the power and incentive to cut that revenue nearly in half by converting those circuits to TELRIC-based UNE rates in the event that Qwest were to begin competing in the MegaBOCs' home territories.[73] Indeed, the mere threat of this response would prevent ILECs from considering out-of-region service offerings in the first instance (particularly over their own facilities).

This potential competitive harm would have grave real-world consequences because Qwest is aggressively pursuing plans to expand its offerings into SBC and Verizon territory, and other ILECs (particularly BellSouth) may wish to do so as well. Indeed, the mergers themselves are ostensibly founded in part upon the claim that it is critical for carriers seeking to serve the national enterprise market to be able to offer such services nationwide. Unfortunately, the MegaBOCs' desire to protect their home regions would also give them the unique incentive to make this threat. For two reasons, then – the sheer scale of the potential revenue loss, and SBC's and Verizon's unique incentive to make the threat – this concern is specific to the SBC-AT&T and Verizon-MCI mergers.[74] Moreover, Qwest, BellSouth, and other ILECs will have no corresponding "hammer" to hold over SBC and Verizon. If the mergers go through, the MegaBOCs will be largely immune from this threat in-region, because they will have purchased the two entities that are by far the largest potential circuit flippers – AT&T and MCI.

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[73] *See id.* ¶ 23.

[74] *See id.* ¶¶ 47-49.

3. *Forbearance Will Reduce the Ability of the Post-Merger MegaBOCs to Cement Their Dominant Positions in the Enterprise Market*

Forbearance also serves the public interest because obliging the ILECs to convert MegaBOC-leased special access circuits would further cement those behemoths' dominance in the enterprise market and erect formidable barriers to entry for competing providers. The resulting market consolidation would ultimately curtail innovation and drastically reduce consumer choice.

The enterprise market is particularly vulnerable to this threat for two reasons. First, as noted above, the market is already highly concentrated, as AT&T and MCI dominate the space and their merger partners are their closest pursuers. Second, enterprise services are increasingly national in scope, and enterprise customers generally return to the providers who have served them in the past, meaning that emerging competitors have difficulty gaining entry into the enterprise market.[75] Significantly, the growing enterprise market is a bellwether for the communications industry as a whole, and allowing anticompetitive conditions to emerge in the enterprise market would have decidedly negative consequences for the broader communications industry.[76]

Absent forbearance, the MegaBOCs could add just a modicum of local traffic to the special access traffic already generated by their existing customers and then demand that other ILECs convert those circuits to UNE rates. In other words, by *adding* an

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[75] *See* Sanford Bernstein Enterprise Report at 41.

[76] The mergers will have a comparably harmful impact in the wholesale market as well. Analyst Sanford Bernstein has noted that "the size of the wholesale market – and therefore the opportunity for wholesale providers – is sensitive to the structure of the telecom industry." Bernstein Research Call, U.S. Telecom: Wholesale Segment Too Large to Sweep Under Rug, But Expected Decline at 2.5% CAGR Through '09, at 10 (Jan. 6, 2005) (attached as Exhibit E). Indeed, the proposed mergers "could decrease the available wholesale revenues for other carriers." *Id.* at 11. When one merger partner is a potential wholesale supplier to the other – as is the case with both proposed mergers – "then they would likely obtain wholesale services from each other, decreasing their reliance on third-party carriers." *Id.*

additional service feature (local service) to the bundles purchased by existing customers, the MegaBOCs would *cut* their input costs by roughly 50 percent, effectively achieving a negative incremental cost of providing service. The circuit-flipping rules thus amount to a regulatory loophole that would allow the MegaBOCs to undercut every other provider in the enterprise market.[77]

While some other enterprise providers could also benefit from this, the merged entities would reap the lion's share of the pricing windfall because AT&T and MCI have the largest inventories of special access circuit leases in the country.[78] Moreover, forcing ILECs to convert MegaBOC-leased special access circuits would only line those carriers' pockets because they are not the high cost marginal producers in the market. Notably, however, this wealth transfer from other ILECs (principally carriers such as Qwest and BellSouth) to the MegaBOCs would not harm only the other ILECs. The other ILECs are among the most likely successful challengers to the MegaBOCs' dominance of the enterprise market. By transferring money from the two ILEC challengers to the MegaBOCs, the circuit-flipping rules make it more likely that the MegaBOCs will be able to cement a comfortable duopoly in the nationwide enterprise market.

4. Forbearance Will Benefit Competition by Reducing the MegaBOCs' Incentive and Ability to Engage in Tacit Collusion to the Detriment of Competition

As Dr. Wilkie explains in greater detail in his Declaration, the "ability to flip circuits may facilitate tacit collusion between SBC and Verizon."[79] Thus, forbearance from applying the circuit-flipping rules to MegaBOCs circuit-conversion requests would

[77] *See* Wilkie Declaration ¶ 20.

[78] *See id.* ¶¶ 13, 18-19.

[79] *Id.* ¶ 35.

also diminish the risk that the merged entities will engage in collusive behavior following consummation of the mergers.

As a matter of economic principle, firms engage in "tacit" collusion when rational behavior (rather than an express agreement to reduce competition) yields "a non-competitive equilibrium in which prices are higher than those that would prevail absent that equilibrium."[80] Predictably, tacit collusion occurs when the profits resulting from such collusion exceed those that would result under competitive conditions.[81]

Dr. Wilkie has calculated that, assuming an obligation to flip MegaBOC-leased circuits, SBC would earn $1.73 billion post merger if it engaged in tacitly collusive behavior, compared to $457 million under competitive conditions.[82] Likewise, post-merger Verizon would earn $800 million in a tacitly collusive arrangement, but only $408 million under competitive conditions.[83] These startling earnings discrepancies lead to a very obvious conclusion: "tacit collusion by SBC and Verizon in wholesale market access is likely and sustainable if they are allowed to flip special access lines."[84] This tacit collusion, Dr. Wilkie explains, "will yield supra-competitive prices in these markets,"[85] which would have a direct and negative impact on consumers.

The Commission should thus forbear from applying its circuit-flipping rules to force other LECs to convert special access circuits for merged entities because, as a matter of rational economic behavior, the MegaBOCs would otherwise have every

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[80] *Id.*

[81] *See id.*¶ 38.

[82] *See id.* ¶ 43.

[83] *See id.*

[84] *Id.*

[85] *Id.*

incentive to collude. Indeed, Verizon and SBC have engaged in tacitly collusive behavior in the past. In the Los Angeles market, for instance, where SBC and Verizon both operate adjacent ILEC networks in highly dense business areas, there is evidence that they have effectively agreed not to compete. In that market, Verizon has only 146 appearances in SBC's territory (out of approximately 13,111 CLEC appearances in SBC territory), and SBC has only 113 appearances in Verizon's territory (out of approximately 7,369 CLEC appearances in Verizon territory).[86] This track record of collusive behavior in the past should put to rest any argument that they would not collude again if given the incentive to do so.

5. *Requiring LECs to Convert MegaBOC-Leased Circuits Would Not Result in Any Economic or Consumer Benefits*

Finally, it bears emphasis that flipping circuits for the MegaBOCs would create particularly troubling economic distortions because there are no corresponding benefits and because circuit flipping would undermine the Applicants' own justifications (*i.e.*, facilities construction and competition outside of the MegaBOCs' regions) for the mergers. As discussed above, the MegaBOCs' enormous resources and massive national market presence demonstrate that they do not need regulatory assistance to compete effectively. Particularly given SBC's and Verizon's repeated acknowledgements that circuit flipping is unnecessary and anticompetitive, it would make little sense to allow them to benefit from the circuit-flipping rules if their mergers are consummated.

Accordingly, consistent with the public interest, the Commission should forbear from forcing ILECs to convert MegaBOC-leased special access circuits to UNEs and

[86] *See id.* ¶ 46.

thereby helping the MegaBOCs turn the enterprise market into a national duopoly. By forbearing, the Commission can ensure that competing providers have access to the critical enterprise market and, as a result, that enterprise customers continue to enjoy a range of service options.

B. Enforcing the Circuit-Flipping Rules is not Necessary to Ensure Just, Reasonable and not Unjustly or Unreasonably Discriminatory Charges, Practices, Classifications or Regulations.

Consistent with the requirements of section 10(a)(1), the MegaBOCs do not need a regulatory handout to ensure that special access charges and practices are just, reasonable and not unjustly or unreasonably discriminatory. First, while forbearance would undoubtedly result in differential treatment of the MegaBOCs (assuming they would flip circuits rather than construct them or purchase them under tariff), it would not rise to the level of unreasonable discrimination. To the contrary, in light of both the MegaBOCs' dominant market positions (especially in the enterprise market) and the unique public policy and competitive harms that allowing them to benefit from the circuit-flipping rules would present, differential treatment under the Commission's UNE rules is entirely reasonable. Second, the merging companies already pay just and reasonable rates for special access services when they purchase them from ILECs under tariffs, and those just and reasonable rates will still be available even if the Commission forbears.

1. *Forbearing from the Requirement that LECs Convert Circuits for the MegaBOCs would not Result in Unjust or Unreasonable Discrimination.*

By forbearing from the requirement that ILECs convert qualifying special access circuits to UNEs only as to the MegaBOCs, the Commission would unquestionably treat

the two industry giants *differently* from other carriers. But *differential* treatment need not – and in this case would not – rise to the level of unjust or unreasonable discrimination, however. As both the Commission[87] and the courts[88] have found, discrimination results only when the regulator treats *similarly situated* entities differently without valid reasons for the differentiation. The MegaBOCs would not be situated similarly to other carriers in any relevant way.

First, as a practical matter, the MegaBOCs would be manifestly different from other telecommunications service providers in terms of their unprecedented financial resources and geographic reach, which give them an unrivaled capability to compete by deploying their own facilities. Moreover, the MegaBOCs would not be "impaired" outside their home regions without access to TELRIC-based UNEs. Not only could the MegaBOCs continue to purchase special access circuits at tariffed rates subject to Commission oversight, but, by virtue of AT&T's and MCI's massive special access purchases, they would also qualify for discounts reducing their special access rates to levels unavailable to most other carriers. Verizon has itself explained this point, indicating that "competing carriers are able to purchase special access at deep discounts off the tariffed 'base' rates . . . – on the order of 5 to 40 percent – when they enter into

[87] *See Inquiry into the Existence of Discrimination in the Provision of Superstation and Network Station Programming,* Second Report, 6 FCC Rcd. 3312, 3313 (¶ 4) (1991) ("The test in Section 202(a) has three components: 1) whether the services in question are like services; 2) whether discrimination has occurred; and 3) whether such discrimination is just and reasonable."); *see also AT&T WATS,* Final Decision and Order, 70 F.C.C.2d 593, 613 (1978) (finding that different rates for like services are "reasonable" under Section 202(a) if they promote the "national economic and social polic[ies]" underlying the Communications Act).

[88] *See Associated Press v. FCC,* 452 F.2d 1290, 1300-01 (D.C. Cir. 1971) ("Not every variation in prices charged customers for a particular feature of the carrier's service supports a claim of unlawful discrimination. Since rate classifications, no less than other classifications, may be justified by differences between the classes, the mere existence of a disparity between particular rates does not establish a statutory violation."); *see also NARUC v. FCC,* 737 F.2d 1095 (D.C. Cir. 1984) ("The Communications Act prohibits unjustifiably different rates for the same service. 47 U.S.C. § 202(a) (1976). But when there is a neutral, rational basis underlying apparently disparate charges, the rates need not be unlawful.").